

BEFORE

THE PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA

DOCKET NOS. 2010-14 --19-C

IN RE:)

)
BellSouth Telecommunications,)
Incorporated d/b/a AT&T Southeast)
d/b/a AT&T South Carolina v.)

Affordable Phone Services, Incorporated)
d/b/a High Tech Communications)
Docket No. 2010-14-C)

)
BellSouth Telecommunications,)
Incorporated d/b/a AT&T Southeast)
d/b/a AT&T South Carolina v. Dialtone)

& More Incorporated)
Docket No. 2010-15-C)

)
BellSouth Telecommunications,)
Incorporated d/b/a AT&T Southeast)
d/b/a AT&T South Carolina v.)

Tennessee Telephone Service, LLC)
d/b/a Freedom Communications USA,)
LLC)

Docket No. 2010-16-C)

)
BellSouth Telecommunications,)
Incorporated d/b/a AT&T Southeast)
d/b/a AT&T South Carolina v. OneTone)

Telecom, Incorporated)
Docket No. 2010-17-C)

)
BellSouth Telecommunications,)
Incorporated d/b/a AT&T Southeast)
d/b/a AT&T South Carolina v. dPi)

Teleconnect, LLC)
Docket No. 2010-18-C)

)
BellSouth Telecommunications,)
Incorporated d/b/a AT&T Southeast)
d/b/a AT&T South Carolina v. Image)

Access, Incorporated d/b/a New Phone)
Docket No. 2010-19-C)

PROPOSED ORDER OF RESELLERS

I. INTRODUCTION

This consolidated matter comes before the Public Service Commission of South Carolina (the “Commission”) on the Complaints (“Complaints”) filed by BellSouth Telecommunications, Incorporated d/b/a AT&T Southeast d/b/a AT&T South Carolina “AT&T” against Affordable Phone Services, Incorporated d/b/a High Tech Communications, Dialtone & More, Incorporated, Tennessee Telephone Service, LLC d/b/a Freedom Telecommunications USA, LLC, OneTone Telecom, Incorporated, dPi Teleconnect, LLC and Image Access, Inc. d/b/a NewPhone (the “Resellers”). In these Complaints, AT&T alleges, among other things, that the individual Resellers owe amounts relating to certain promotional offerings which AT&T offers to its end-use customers.

On January 20, 2010, the Commission consolidated the above-referenced dockets for hearing purposes. Pursuant to the parties’ Joint Motion on Procedural Issues filed May 20, 2010, as granted by Commission Hearing Officer Directive dated August 20, 2010, a consolidated proceeding was convened for the limited purpose of addressing the following common issues (the “Consolidated Phase”): (1) how cash back credits to Resellers should be calculated; (2) whether the word-of-mouth promotions are available for resale, and if so, how the credits to Resellers should be calculated; and (3) how credits to Resellers for waiver of the line connection charge should be calculated. The parties jointly filed Stipulations for the Consolidated Phase on July 23, 2010 (“Stipulations”). AT&T and the Resellers filed direct and rebuttal testimony in the Consolidated Phase.

A hearing was held on December 16, 2010, at 10:30am in the Commission’s Hearing Room, with the Honorable John E. “Butch” Howard, Chairman, presiding. AT&T was represented by Patrick Turner, Esquire, and presented the direct and rebuttal testimony of Dr.

William Taylor. The Resellers were represented by John J. Pringle, Jr., Henry Walker, Christopher Malish, and Paul F. Guarisco, and presented the direct and rebuttal testimony of Joseph Gillan and Dr. Christopher Klein.

II. FACTS

A. Stipulated Facts

There are three types of promotions that are being considered by the Commission in the Consolidated Phase: Cashback Offerings, Referral Marketing (“Word-of-Mouth”), and Line Connection Charge Waiver (“LCCW”).

As set out in the Stipulations submitted to the Commission and incorporated by reference herein, the parties have no disagreement regarding either the general description of the representative types of promotions that constitute Cash-back Offerings, Word-of-Mouth, and LCCW, or the general description of the representative types of AT&T retail offerings subject to those promotions. As described in the Stipulations and below, the parties agree on how AT&T implements these promotions for both its own retail customers and on a wholesale basis to qualifying resellers.

B. Additional Facts

The Resellers resell AT&T’s retail residential telephone services. AT&T often offers its retail customers promotional discounts and rebates which AT&T is required to make available to Resellers. The dispute centers on credits which are owed to the Resellers as a result of the Resellers purchasing these promotional offerings from AT&T.

Costs are not necessarily directly related to the price for a service. “Cost” and “price” are two different concepts:

- “Cost” is the value of the products and services which are necessary to produce a unit of output.
- “Price” is the value or what a customer has to give up in order to acquire a product or service.
- Simply because a price changes does not necessarily mean that a cost has changed. It certainly doesn't cause a cost to change.¹

There will always be costs associated with providing service, regardless of the level of the sales price – even if the service is given away for free, or if the customer is given cash to take the service for one of the months that it is offered.²

The Commission has set BellSouth/AT&T's avoided costs in the wholesale context at a percentage of the standard retail price of the respective telecommunications service. When originally determined by this Commission, the avoided cost was based on, and calculated from, BellSouth/AT&T's pre-promotion (or standard/tariffed) retail rate. This is considered a reasonable approximation by all parties.³

Because the wholesale price is based on the retail price (whether positive or negative), from which one deducts the costs avoided, is clear from context that the Act and the rules

¹ Deposition of William E. Taylor, Ph.D., October 21, 2010, p. 8, line 19 through p. 9, line 6 and p. 10, lines 7 – 11.

² Deposition of William E. Taylor, Ph.D., October 21, 2010, p. 104, lines 8 – 23:

MR. MALISH: The cost of providing the service doesn't change just because there's a promotion that's made applicable to that service, does it?

DR. TAYLOR: It certainly doesn't. That cost of providing the service doesn't change if the company for whatever reason decided to change the price from 50 to 40.

MR. MALISH: Okay..

DR. TAYLOR: (Indicating).

MR. MALISH: So that the – changing the – Whether there's a promotion of 50 or a hundred or no promotion at all, the costs of providing under the – the underlying service does not change?

DR. TAYLOR: Correct. And as the price of the service changes, the underlying costs don't change because the price changed.

³ Deposition of William E. Taylor, Ph.D., October 21, 2010, p. 22, 27

promulgated thereunder to expect that the wholesale price should necessarily always be less than the retail price.⁴

The costs of providing a particular service do not change, even if some purchasers of that service may be able to purchase the service at a special sale, or promotional price. In other words, the avoided cost is the same for both a service sold at the standard retail rate, and that same service sold pursuant to a special sale, or promotional rate.⁵

A cash back promotion, if available to a qualifying order, applies a single time and is paid in a single lump sum. It is not paid out over time; for example, a \$50 cash back promotion is paid by a single check for \$50, not a \$5 payment each month for 10 months. An end user need not maintain qualifying services for more than 30 days in order to qualify for a cash back promotion.

⁴ Transcript of Testimony and Proceedings, p. 129, lines 5 – 14, *e.g.*:

MR. GUARISCO: And there's a discussion at the bottom of page 12 and into page 13 with regard to the overarching principles involved in the resale obligations of the [federal Telecommunications] Act [of 1996] and that the resale price to the CLECs would be less than the retail price of the ILEC?

DR. TAYLOR: Yes.

MR. GUARISCO: Do you see that at the bottom of page 12?

DR. TAYLOR: Right. My answer is that's certainly the expectation of the Act, because the Act and the FCC never contemplate that a price would be negative.

⁵ Deposition of William E. Taylor, Ph.D., October 21, 2010, p. 104, lines 8 – 23:

MR. MALISH: The cost of providing the service doesn't change just because there's a promotion that's made applicable to that service, does it?

DR. TAYLOR: It certainly doesn't. That cost of providing the service doesn't change if the company for whatever reason decided to change the price from 50 to 40.

MR. MALISH: Okay..

DR. TAYLOR: (Indicating).

MR. MALISH: So that the – changing the – Whether there's a promotion of 50 or a hundred or no promotion at all, the costs of providing under the – the underlying service does not change?

DR. TAYLOR: Correct. And as the price of the service changes, the underlying costs don't change because the price changed.

The question before the Commission is how to determine the amount a reseller is entitled to when reselling services subject to cash back promotions for the single month when the promotion is processed. No other months are in dispute.⁶

Three methods have been identified for determining the avoided cost discount (wholesale discount) when promotions are involved:

- (1) calculating the wholesale (cost avoided) discount associated with a service from the standard/tariffed cost avoided for that service; this is the method advocated by Resellers;
- (2) calculating the wholesale (cost avoided) discount associated with a service as a percentage of the standard/tariffed price less a percentage of the cash back promotion amount. This is the method currently used and advocated by AT&T under the theory that it resulted in “reducing” the net retail price by the wholesale discount (*see e.g.* Taylor Direct at 16, 18, 20, 22); and
- (3) calculating the wholesale (cost avoided) discount associated with a service as a percentage *less than* the net retail price for that service; or, stated in algebraic form, the wholesale price is made equal to the effective retail rate reduced by the amount arrived at by multiplying the *absolute value* of the effective retail rate by the discount percentage rate:

$$\text{Wholesale} = (\text{retail price} - \text{cash back}) - \% * \text{ABS}(\text{retail} - \text{cash back})$$

⁶ See, e.g., Transcript of Testimony and Proceedings, p. 131, lines 15 - 21.

Mr. Guarisco: Q. But isn't it true that the retail customer receives a \$25 one-time promotional credit?

Dr. Taylor: A. Yes.

Mr. Guarisco: Q. And that one-time promotional credit isn't allocated over many months, is it?

Dr. Taylor: A. He receives - he or she receives the check in one month.

See also, p.130, lines 16 - 18:

Mr. Guarisco: Q. Right. But isn't it also true that the cashback promotion is a one-time cash incentive?

Dr. Taylor: A. Yes, it is a one-time cash incentive.

See also Pre Filed Direct Testimony of Dr. William Taylor at p. 14, lines 8 - 11:

Q. What are the Cashback Promotions?

A. As described in Attachment A to the Stipulations, a cashback promotion is an offer that provides a one-time cash or near-cash incentive for customers to subscribe to a service.

This is how one would correctly express mathematically the concept of having the effective retail rate being *reduced* by a particular percentage.

A comparison of the results from applying these three methodologies to illustrative price points and promotion amounts is produced in Table 1, below.

Table 1 Comparison of wholesale price using various calculation methods.						
Standard Retail Price	Standard Wholesale Discount Percentage	Promotion Amount	Net Retail Price ¹	Method 1: Reseller: Net Wholesale Price assuming avoided cost calculated as % of standard retail price ²	Method 2: AT&T 'less than': Net Wholesale Price assuming avoided cost calculated as % of standard retail price less % of promotion ³	Method 3: True 'less than': Net Wholesale Price assuming avoided cost calculated as % 'less than' net retail price ⁴
\$25	20%	–	\$25	\$20 (\$5 less than net retail)	\$20 (\$5 less than net retail)	\$20 (\$5 less than net retail)
\$25	20%	\$25	\$0	-\$5 (\$5 less than net retail)	\$0 (same as net retail)	\$0 (same as net retail)
\$25	20%	\$50	-\$25	-\$30 (\$5 less than net retail)	-\$20 (\$5 MORE than net retail)	-\$30 (\$5 less than net retail)
\$25	20%	\$100	-\$75	-\$80 (\$5 less than net retail)	-\$60 (\$15 MORE than net retail)	-\$90 (\$15 less than net retail)

1. Standard Retail Price - Promotional Discount = Net Retail Price
2. Standard Retail Price x Wholesale Discount Percentage = Avoided Costs
Standard Retail Price- Promotional Discount - [Avoided Costs] = Net Wholesale Price
3. (Standard Retail Price x Wholesale Discount Percentage) -
(Promotional Discount x Wholesale Discount Percentage) = Avoided Costs
4. Wholesale Discount Percentage "Less Than" Net Retail Price = Net Wholesale Price; that is,
Wholesale = (retail price – cash back) – % *ABS(retail – cash back)

The first (Resellers' proposed) method uniformly produces a wholesale price that is lower than the retail rates by the fixed amount determined by applying the discount percentage to the standard/non-promotional retail rate.

The second method (advanced by AT&T as "reducing" the effective retail rate by a fixed percentage) results in situations where the wholesale rate is higher than the retail rate, and the costs avoided in providing the service are not subtracted from the net retail rate.

The third method is the mathematically correct way to express the concept that the wholesale rate should be the retail rate reduced by a given percentage.

III. STIPULATED ISSUES

As described in the Stipulations and the parties' Joint Motion on Procedural Issues, the following issues are disputed and have been placed before the Commission in the Consolidated Phase:

(1) How should Cashback Offering and LCCW credits to Resellers be calculated? Because the parties have asked the Commission to assume that a Reseller is entitled to receive these promotional credits, the only dispute between AT&T and the Resellers is the amount of the credits.

(2) Word-of-Mouth

a) Is the Word-of-Mouth promotion subject to the resale obligations of the federal Telecommunications Act of 1996 (the "Act") and other applicable law?

b) If the Commission determines that the Word-of-Mouth promotion is subject to such resale obligations, and assuming that a Reseller is entitled to receive a promotional credit, how should that credit be calculated? In other words, what is the amount of that credit?

IV. LEGAL STANDARDS UNDER THE FEDERAL TELECOMMUNICATIONS ACT

Federal law provides, among other things, the following with respect to the terms and condition of resale, including the obligation to make promotions available to resellers:

- 47 U.S.C. § 251(c)(4)(A). ILECs have the duty to “offer for resale at wholesale rates any telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers.”
- 47 C.F.R. § 51.605(a). ILECs “shall *offer* to any requesting telecommunications carrier any telecommunications service that the [ILEC] *offers* on a retail basis to subscribers that are not telecommunications carriers for resale at wholesale rates....” [Emphasis added.]
- 47 U.S.C. § 251(c)(4)(B). ILECs have a duty not to “prohibit, and not to impose unreasonable or discriminatory conditions or limitations on, the resale of such telecommunications service.”
- 47 C.F.R. § 51.603(b). “A LEC must provide services to requesting telecommunications carriers for resale that are equal in quality, *subject to the same conditions*, and provided within the same provisioning time intervals that the LEC provides these services to others, including end users.” [Emphasis added.]
- 47 C.F.R. § 51.613(a)(2). “The following types of restrictions on resale may be imposed: Short term promotions. An incumbent LEC shall apply the wholesale discount to the ordinary rate for a retail service rather than a special promotional rate only if:
 - (i) Such promotions involve rates that will be in effect for no more than 90 days; and
 - (ii) The incumbent LEC does not use such promotional offerings to evade the wholesale rate obligation, for example by making available a sequential series of 90-day promotional rates.”

Federal law provides, among other things, the following with respect to calculating the wholesale price of retail services which must be resold:

- 47 U.S.C. § 252(d)(3). “Wholesale prices for telecommunications services. For the purposes of section 251(c)(4) of this title, a State commission shall determine *wholesale* rates on the basis of *retail* rates charged to subscribers for the telecommunications service requested, *excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided* by the local exchange carrier.” [Emphasis added.]
- 47 C.F.R. § 51.607. “The wholesale rate that an incumbent LEC may charge for a telecommunications service provided for resale to other telecommunications carriers shall equal the rate for the telecommunications service, *less avoided retail costs*, as described in section 51.609.” [Emphasis added.]

The Commission has determined that AT&T’s avoided retail costs equal 14.8 % of the standard retail price. Order on Arbitration, *In Re: Petition of AT&T Communications of the Southern States, Inc. for Arbitration of an Interconnection Agreement with BellSouth Telecommunications, Inc.*, Order No. 97-189 in Docket No. 96-358-C (March 10, 1997). Accordingly, the “avoided cost discount” or “resale discount” is 14.8%.

V. DISCUSSION

The resale discount of 14.8 % was established by the Commission in 1997, and has been applied continuously since that time. We emphasize that we have not been presented with any proposal to change that avoided cost discount, and our decisions in the Consolidated Phase will not alter that avoided cost discount in any way. In this Consolidated Phase, the Commission determines how the resale discount is applied to calculate the wholesale rate for the Cash Back and Line Connection Charge Waiver promotions, which are required to be made available for resale, to determine the credits due Resellers. Further, the Commission will consider *whether* the Word-of-Mouth promotion is available for resale, and if so, how should the credit due Resellers should be calculated.

A. The Proper Calculation of Credits Associated with Cash-Back Promotions to Resellers

Background

The parties have no fundamental disagreement in defining a “cash-back” promotion. Reseller witness Gillan defines a cash-back promotion as “a category of promotion where a cash payment, gift card, coupon, checks or other similar giveaways are offered as part of a particular promotion.” (Tr. p. 196). AT&T witness Taylor defines a cash-back promotion as “an offer that provides a one-time cash or near-cash incentive for customers to subscribe to a service. It often takes the form of a coupon to be mailed back or an online redemption process.” (Tr. p. 53).

The parties have further stipulated the procedures through which AT&T processes a request for a promotional offering:

AT&T’s Procedure for Processing a Retail Request for a Promotional Offering

AT&T bills its retail customer the standard retail price for the services subject to the “cash-back” offering. The AT&T retail customer then requests the benefits of the cash-back promotion either on-line or by mailing in a form within the allowable time period set by the terms and conditions of that particular promotion. If the retail customer meets the qualifications of the promotional offering, AT&T mails a check, gift card, or other item (as may be described in the promotional offering) to the retail customer’s billing address.

AT&T’s Procedure for Processing a Wholesale Request for a Promotional Offering

When a Reseller purchases for resale the telecommunications services that are subject to promotional offerings described above, AT&T bills the Reseller the wholesale rate (the retail rate less the 14.8% resale discount) for those services. After being billed by AT&T, the Reseller submits promotional credit requests seeking any credits to which it claims entitlement. To the

extent that AT&T determines that the Reseller is entitled to the requested credits, AT&T applies those credits on a subsequent bill to the Reseller.

Proposals/Positions of the Parties

Resellers

As described by witness Joseph Gillan, the Resellers propose that AT&T 1) bill the monthly retail price of the service less the 14.8 % resale discount; and 2) provide the Resellers a one-time bill credit in the amount of the retail cash-back amount. Tr. p. 203. The Reseller Proposal is demonstrated by the following equation:

$$\text{Wholesale Rate} = (\text{Discount}) \times (\text{Retail Rate}) - (\text{Cash-Back})$$

For purposes of this equation and as used throughout this Order, “Discount” is calculated as (1 – Resale Discount %), or 85.2 %.

AT&T

As described by AT&T witness Dr. Taylor, AT&T’s proposed method is to 1) bill the Reseller the monthly retail price of the service less the 14.8 % resale discount; and 2) provide the Reseller a one-time bill credit in the amount of the retail cash-back amount less the 14.8 % resale discount. (Tr. p. 53). The AT&T proposal is demonstrated by the following equation:

$$\text{Wholesale Rate} = (\text{Discount}) \times (\text{Retail Rate}) - (\text{Discount}) \times (\text{Cash-Back})$$

Discussion

We will consider the appropriate calculation of credits associated with the Cashback Offerings in light of those provisions of the Act and the FCC Rules that apply to our analysis.

Section 252(d)(3) of the Act states:

Wholesale prices for telecommunications services. For the purposes of section 251(c)(4) of this title, a State commission shall determine *wholesale* rates on the basis of *retail* rates charged to subscribers for the telecommunications service

requested, *excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided* by the local exchange carrier. [Emphasis added].

47 C.F.R. § 51.607 reiterates that

“The wholesale rate that an incumbent LEC may charge for a telecommunications service provided for resale to other telecommunications carriers shall equal the rate for the telecommunications service, *less avoided retail costs*, as described in section 51.609.” [Emphasis added.]

The Act and federal regulations (particularly 47 C.F.R. § 51.607) set the resale rate for telecommunications services that an ILEC may charge at “the rate for the telecommunications service, less avoided retail costs” Thus, the “wholesale discount” must by law be calculated as the *avoided cost*, as opposed to a particular percentage. The plain language of both Section 252(d)(3) of the Act and FCC Rule 607 require AT&T’s “retail rates” and the “rate for the telecommunications services” to be the starting point for the determination of the “wholesale rate,” and further require that the “avoided retail costs” be deducted or excluded from the retail rate to determine that wholesale rate. Thus, it is clear from context that the FTA and the rules promulgated thereunder expect that the *wholesale price should be less than the retail price*. AT&T’s witness Dr. Taylor concedes that the Act and the FCC’s rules presume that the wholesale price must be less than the retail price.⁷

⁷ Transcript of Testimony and Proceedings, p. 129, lines 5 – 14, *e.g.*:

MR. GUARISCO: And there’s a discussion at the bottom of page 12 and into page 13 with regard to the overarching principles involved in the resale obligations of the [federal Telecommunications] Act [of 1996] and that the resale price to the CLECs would be less than the retail price of the ILEC?

DR. TAYLOR: Yes.

MR. GUARISCO: Do you see that at the bottom of page 12?

DR. TAYLOR: Right. My answer is that’s certainly the expectation of the Act, because the Act and the FCC never contemplate that a price would be negative.

The calculation of wholesale rates per the Act and the FCC Rules by this Commission historically has been straightforward and uncontested: avoided retail costs are removed by multiplying the Discount by the retail rate to obtain the wholesale rate. Indeed, the Resellers propose that the Commission conduct the same mathematical calculation in this case, multiplying the retail rate for the service in question by the Discount to arrive at the wholesale rate.

AT&T, however, presents the Commission with an argument that we have not previously considered or addressed: that the avoided cost associated with a service should be based not upon the standard or tariffed rate for the service, but what AT&T has termed the “effective retail price” (the retail rate less the value of the cash-back promotion). In other words, we are called upon to determine for the first time whether the existence of a cash-back promotion somehow reduces the avoided cost otherwise associated with the service, and which is thereafter subtracted from the retail price in order to arrive at the wholesale rate.⁸

AT&T arrives at its proposed wholesale price by applying the discount percentage to both the standard retail rate, and the promotion amount – on the theory that so doing is the mathematical equivalent of applying the discount a single time to (and thereby “reducing”) the “effective retail rate” (the “effective retail rate” is defined as the standard rate minus the value of the promotion). Because AT&T applies the resale discount to the retail price of the service initially before its calculation of credits, the difference between AT&T’s proposal and that of the Resellers in monetary terms is the dollar amount equal to the resale discount multiplied by the

⁸ We further note, as set out in the Stipulations, AT&T did not seek prior approval for the methodology it used to calculate the amount of promotional credits to the Resellers.

value of the cash-back promotion. Therefore, we must consider whether the Act and FCC Rules allow the value of the cash-back promotion to be discounted.

As noted above, the Act and 47 C.F.R. § 51.607 set the resale rate for telecommunications services that an ILEC may charge at “the rate for the telecommunications service, less avoided retail costs....” Thus, the “wholesale discount” is actually defined as the avoided cost, as opposed to a specific percentage. Also, it is clear from context that the Act and the rules promulgated thereunder expect that the *wholesale price should be less than the retail price*. Moreover, as again noted above, there is no dispute that this is the case.⁹

AT&T’s proposal, however, results in instances where the wholesale rate is actually higher than the retail rate -- a consequence at odds with the plain language of Rule 607 and the purposes of the Act. The AT&T methodology produces a result contrary to the purposes of the resale provisions of the Act - a wholesale price that is higher than the retail price. Accordingly, AT&T’s model cannot be correct. It is not possible to comply with the federal wholesale pricing standard with a wholesale price that is *greater* than the retail rate as proposed by AT&T. The only way that the wholesale pricing standard could be satisfied by a wholesale rate greater than the retail rate is if there are negative avoided costs that when subtracted from the retail rate,

⁹ Transcript of Testimony and Proceedings, p. 129, lines 5 – 14, *e.g.*:

MR. GUARISCO: And there’s a discussion at the bottom of page 12 and into page 13 with regard to the overarching principles involved in the resale obligations of the [federal Telecommunications] Act [of 1996] and that the resale price to the CLECs would be less than the retail price of the ILEC?

DR. TAYLOR: Yes.

MR. GUARISCO: Do you see that at the bottom of page 12?

DR. TAYLOR: Right. My answer is that’s certainly the expectation of the Act, because the Act and the FCC never contemplate that a price would be negative.

produce a higher number.¹⁰ However, there is no such thing as a “negative avoided cost;” as conceded by Dr. Taylor, the retail price of a telecommunications service is never negative.¹¹

As explained by Reseller witness Gillan:

[T]he purpose of the wholesale discount is to *remove* marketing and customer-care costs from a retail price so that the wholesale price is lower than the retail price (by the estimate of avoided cost). This requirement is *fully* accomplished when the discount is applied to the retail rate (which is the first term of the equation); there is no continuing role for the wholesale discount in the calculation. Once applied to the retail rate, the proper estimate of the avoided cost is removed and the full purpose of the wholesale discount is achieved.

AT&T’s calculation is the perfect example of an algebraic equation disconnected from reality. The way AT&T applies the discount [to both the retail rate and promotion], it is artificially reducing the avoided-cost estimate, as though there are negative avoided costs that can be “added-back” to the calculation. But there is no such thing as a “negative avoided cost.” Significantly, there is nothing in AT&T’s testimony that tries to explain what changed during the promotional month that would justify AT&T removing fewer avoided costs in that month than in every other month for the same service.¹²

Rule 607 provides that the wholesale price “shall equal the rate for the telecommunication service, *less* avoided costs.” (Emphasis added). As explained by Reseller witness Gillan (Tr. pp. 220-221), Dr. Taylor’s direct testimony demonstrates how the AT&T proposal results in a wholesale price higher than the retail price. (Tr. p. 67). As such, the Reseller Proposal squares with the language of Rule 607 more completely. In light of this, Resellers are entitled to the full, dollar-for-dollar value of an ILEC’s promotional offerings to the same extent as retail customers. Thus, the appropriate method for determining the wholesale price is to first calculate the amount of the avoided cost by applying the 14.8% discount to the standard retail rate, then subtract the avoided cost from the actual sales price.

¹⁰ *Id.*

¹¹ Transcript of Testimony and Proceedings, pp. 123 – 124.

¹² Gillan Rebuttal Testimony, p. 10, lines 4 – 19.

AT&T's contention that the FCC intended for states to establish the wholesale price "by means of a percentage discount off the retail price" (Tr. at p. 94) does not provide the Commission with guidance in our consideration of this issue. But the question before us is what is the appropriate "retail price" to use *in calculating the avoided costs* associated with the service in question and the requirement that any wholesale price resulting from that retail price be determined only by removing avoided retail costs.

AT&T's citation to the FCC's *First Report and Order* and AT&T's contention that the "avoided cost discount pricing rule would be implemented by use of a *rate* . . . rather than by subtracting a dollar amount of avoided costs for a particular service from the retail price" (Tr. at 93), is curious, because it describes exactly how the Commission calculates the wholesale rate on a uniform basis: the wholesale rate is determined by subtracting the avoided retail costs, which equal a "percentage discount" of the standard retail rate.

As discussed above, the Act and Rule 607 make clear that the only difference between the wholesale rate and the retail rate is the avoided retail costs. The cited passage from the *First Report and Order* merely grants states the authority to "approve nonuniform wholesale discount rates" as long as the appropriate cost studies have been performed. This Commission has not done so, and no such request to do so has been presented to the Commission in this case.

Finally, AT&T's arguments that the Resellers' proposal improperly increases the resale discount above the 14.8% set by this Commission (Tr. at p. 61) also miss the mark, because the 14.8% is the percentage applied to the standard rate in order to calculate the avoided costs associated with the service in question. In any event, we note that applying AT&T's method, the net wholesale price is not *reduced* by 14.8%, but *increased* by 14.8%.

Retail/Wholesale Parity

The Commission is also troubled by the fact that under the AT&T proposal the value of the cash-back discount is less for the Reseller than for an AT&T retail customer. Section 251(c)(4)(B) of the Act makes clear that AT&T cannot “impose unreasonable or discriminatory conditions or limitations on, the resale of” the promotions at issue in this case, and Rule 603(b) requires that AT&T resell its services “subject to the same conditions, and provided within the same provisioning time intervals” that AT&T provides to its retail end-user customers. Thus, CLECs are entitled to the full value of AT&T’s cash back promotions. For example, when AT&T offers retail telephone service in conjunction with a “\$50 cash back” rebate to new customers, AT&T must make that offer available to CLECs “under the same conditions,” that is, with a \$50 cash rebate, and “at the rate for such telecommunications services less the avoided retail costs,” that is, at the tariffed retail price less the wholesale discount. FCC rules unambiguously place the reseller in the shoes of the retail customer when it acquires a service for resale. The FCC rules make clear that no additional conditions can be placed on the reseller, particularly any condition that would have the effect of imposing some restriction on the reseller that does not apply to AT&T retail customers. As such, resellers are fully entitled to the cash-back payment as an end-user. To provide any less – or to impose any other qualifying requirements – violates the Act and FCC rules prohibiting any additional conditions or restrictions on the reseller.

There is no dispute that under AT&T’s proposal its retail customer purchasing a \$75 retail service receives the full benefit of the \$50 cash-back reward. The Reseller, on the other hand, pays the wholesale rate for the underlying service, and would receive a credit of only \$42.60 (\$50 less the resale discount). (Tr. p. 217). The Reseller proposal results in a credit of

\$50, equal to the credit AT&T provides to its retail customer, and avoids any possible inconsistency with Rule 603(b).

The Significance of the Cash-Back Credit as a Rebate

As described herein, the Resellers' proposal in certain aspects comports with the language and purpose of the Act and the FCC Rules more fully than AT&T's proposal. AT&T's proposal is further called into question by the aspects of the cash-back offer that make it more akin to a rebate than a "retail rate." The promotions at issue require that the consumer take some action in order to receive the benefit of the cash-back amount: the value of the promotion does not automatically apply. That aspect alone distinguishes the cash-back promotion from the "rates" to which the Commission has applied the resale discount. As Commissioner Fleming stated in a discussion with AT&T witness Dr. Taylor, describing what happens if a customer does not take action to receive that benefit: "But I didn't get it because I didn't sent it in." (Tr. p.169).

AT&T itself describes the \$50 cash back payment to retail customers as a "Rebate." In Attachment E of the Stipulations, AT&T responds to "Frequently Asked Questions" and repeatedly refers to the Cash Back payments as a "rebate." On these pages, AT&T instructs customers how to apply for the "rebate" which the customer may receive "4 to 6 weeks" after purchasing AT&T's service. In other words, the \$50 cash back promotion is a true rebate, as AT&T acknowledges, not a discount and it should not be treated as a discount when AT&T calculates how to pass on these promotional credits to the Resellers. That the CashBack Offering has many characteristics of a rebate as opposed to a "retail rate" further demonstrates that the Reseller proposal is more consistent with applicable law than the AT&T proposal.

The *Sanford* Case

The parties have provided the Commission with their positions on the effect and import of *BellSouth Telecommunications Incorporated v. Sanford*, 494 F.3d 439 (4th Cir. 2007) (“*Sanford*”). *Sanford* involved the Fourth Circuit Court of Appeals’ review of two orders of the North Carolina Utilities Commission (“NCUC”) determining that BellSouth Telecommunications, Inc. (“BellSouth”) was required to provide certain incentive offers it provided to its retail customers to resellers. BellSouth challenged the NCUC orders in federal district court on the basis that requiring BellSouth to provide those incentive offers for resale violated the Act and the FCC Rules. The district court reversed the NCUC, and the Fourth Circuit determined that the district court “erred in concluding that the NC Commission’s orders violated the Telecommunications Act, the regulations promulgated under it, and the FCC’s Local Competition Order.” *Sanford*, 494 F.3d at 453.

The core holding of *Sanford* is that if an ILEC offers a promotion that tends to affect the retail price of a service, it must be offered in turn to CLECs. While the *Sanford* court was not tasked with setting the wholesale prices when promotions are in play, *Sanford* does make it clear that the wholesale rate must be lower than retail price to give effect to the Act and the FCC’s Rules. Because AT&T’s proposed method results in wholesale rates that are greater than the retail rate, AT&T’s method is not consistent with the holding in *Sanford*.

By “discounting” the promotions- and thereby effectively reducing the amount of the wholesale discount – AT&T turns the key holding from *Sanford* on its head. In nearly all instances involving the cash back promotional offering at issue in this proceeding, AT&T has used the Commission’s wholesale discount to subject resellers to a *higher* price for the underlying telecommunications service when compared to the effective retail rate to end-use customers. For example, if the retail rate of an AT&T telecommunications service is \$25, and

AT&T offers a \$50 cash back promotion in the first month to customers who order that service, a AT&T retail customer would receive a credit of \$25 as a result of the promotion at the normal retail rate (\$25 service less the \$50 cash back, resulting in a -\$25 effective retail rate). In the resale context, however, AT&T has been *increasing* the -\$25 received by its customers by the 20% discount factor normally applied to the standard rates to arrive at a price of -\$20 (-\$25 *increased* by 20%), or a credit of \$20 to resellers. The effect of AT&T's methodology is to increase the cost to CLECs, through a smaller promotion credit, as compared to the same service purchased by an AT&T customer. Thus, the AT&T method is contrary to the purpose underlying the Commission's wholesale discount and the rationale of *Sanford*.

Additional AT&T Arguments in Support of its Proposal

AT&T presents various arguments that the Reseller proposal is inconsistent with the competitive purposes of the Act. These include the allegations that the end-user customer of the Resellers may not receive the benefit of the cash-back promotion (Tr. at p. 63), that Resellers may not compete on price with AT&T (Tr. at p. 107), and that Reseller end-user customer "churn" may be significant (Tr. at p. 112). The Commission considers these arguments speculative at best, and declines to assign any significant weight to them. As described above, the Commission has already determined that the Reseller proposal is consistent with the Act and the FCC Rules: the Reseller would pay AT&T exactly what the Reseller would pay if the cash-back offering did not exist, and the Reseller would receive the full value of the cash back promotion in exactly the same amount as the AT&T retail customer. Thus, the Reseller proposal also furthers the pro-competition goals and purpose of the Act.

The Word-of-Mouth Promotion

1. Availability for Resale

The Word-of-Mouth promotion allows an AT&T customer to receive a \$50 rebate for referring a new customer to AT&T. The benefit to AT&T is no different than when a new customer signs up for AT&T service and receives a \$50 cash rebate directly from AT&T.

As a result of the *Sanford* decision, AT&T is required to offer the Resellers the benefit of a \$50 cash back promotion, but AT&T unreasonably refuses to offer the Resellers the benefit of the \$50 Referral promotion. The *Sanford* court rejected AT&T's argument that promotional offerings were not subject to the resale discount. AT&T now repeats that argument, attempting to apply it to the Word-of-Mouth. Legally and logically, the two promotions are exactly the same. In both cases, AT&T offers a \$50 rebate in exchange for gaining a new customer. In one case, the money is paid to the new customer himself. In the other case, the rebate is paid to an existing AT&T customer who persuades someone else to purchase AT&T's service. There is no reason that one promotion is available for resale and the other is not. AT&T is simply trying to limit the application of *Sanford* to promotions which are expressly described in the Court's opinion and not apply the Court's holding to other, very similar promotions.

Dr. Taylor attempts to argue that the Referral promotion is a "marketing expense" for AT&T and therefore that this promotion is not subject to the Act's resale provisions. This is exactly the same argument that AT&T made – and lost – in the *Sanford* case. This promotion is a condition of service, subject to the Act's resale obligations to the same extent as provided to retail customers. As correctly pointed out by Reseller witness Dr. Christopher Klein:

The Word-of-Mouth referral is just a rebate for which a customer must qualify by referring another customer to AT&T. FCC rules require rebates to be available for resale.... Dr. Taylor's objections to the resale of this offering are just attempts to obscure the simplicity of the rebate or to complicate the analysis by referring to the rebate as a marketing expense. AT&T's classification of the rebate for its own internal purposes is irrelevant. The Word-of-Mouth referral rebate is offered to AT&T customers as a term or condition of service and should be made available for resale. Otherwise, AT&T is evading its resale obligations.¹³

As such, this promotion is subject to the same resale obligation as the Cashback and LCCW promotions. AT&T must offer the full value of the word-of-mouth promotion to the Resellers.

2. The Proper Calculation of Credits to Resellers For the Word of Mouth Promotion

Consistent with the Reseller proposal we adopt above, AT&T must provide to Resellers the cash value of the full referral benefit that AT&T provides to its referring retail customer.

B. The Proper Calculation of Credits to Resellers for the Line Connection Charge Waiver

Similar to the cash back promotion fully discussed herein, AT&T also offers a line connection charge waiver ("LCCW") promotion to its end-users. As explained by Reseller witness Dr. Christopher Klein:

The LCCW waives the line connection charge for select customers. Those customers are not charged for and do not pay the connection charge. The Stipulations describe the resale of the LCCW as requiring the reseller to pay the standard wholesale rate up front, then to apply for the waiver. If the reseller's customer qualifies for the LCCW, then the reseller receives a credit. From the reseller's perspective, the LCCW also functions as a rebate. Dr. Taylor makes the same point in likening the LCCW to a cash back offer.¹⁴

In other words, the LCCW promotion takes the same form as the cash back promotion as it applies to resellers. As AT&T's witness Dr. William Taylor agreed, the cash back arguments

¹³ Klein Rebuttal Testimony, p. 13, lines 2 – 11.

¹⁴ Klein Rebuttal Testimony, p. 7, lines 5 – 10. (Tr. p. 283).

described in the testimony of Mr. Joseph Gillan and Dr. Christopher Klein are equally applicable to the calculation of the LCCW amount. As Dr. Taylor stated in his pre-filed testimony:

Alternatively, one could treat the \$40 LCCW as a cashback promotion because the value of that promotion is relatively unambiguous (the \$40 the retail customer saves) and all customers are likely to value that benefit similarly – like cash.¹⁵

As in the case of cash back promotions, a Reseller is entitled to the LCCW promotion to the same extent as AT&T's retail customers. As correctly recognized by Dr. Klein when explaining rebates such as the LCCW promotion:

A rebate does not change the standard or "tariffed retail rate paid by the consumer, so the wholesale rate for the service is not changed. That is, the wholesale rate remains the standard retail rate less the avoided cost discount.... The rebate is credited to the reseller when it applies for the rebate for a qualifying customer in the same way the rebate is credited to a qualifying AT&T retail customer. Thus, the FCC's rules that require a service to be offered under the same terms and conditions at wholesale as at retail are satisfied.

For the reseller, the LCCW is also in the form of a rebate. The wholesale rate for the LCCW should be calculated by applying the avoided cost discount to the standard retail rate, and giving the reseller the same rebate that the retail customer receives.¹⁶

VI. CONCLUSION

The Commission concludes that the Resellers are entitled to the Cash Back, LCCW and Word-of-Mouth promotional offerings at issue in this proceeding to the same extent and under the same terms and conditions as provided to AT&T retail customers. AT&T must resell its telecommunications services to the Resellers at the retail rate less the Commission's estimate of avoided cost (which is the same for the month in which the promotional credit is processed as every other month), and the promotional offerings associated with these telecommunications

¹⁵ Taylor Direct Testimony, p. 31, lines 10 – 12. (Tr. p. 70).

¹⁶ Klein Rebuttal Testimony at p. 8, line 19 through p. 9, line 2 and p. 9, lines 8 – 10. (Tr. pp. 284-285),

services must be made available to the Resellers on a dollar-for-dollar basis when compared to retail customers.

IT IS THEREFORE ORDERED THAT:

1. AT&T shall calculate credits for the Cash-Back promotions using the Reseller Method described herein;
2. AT&T shall make the Word-of-Mouth referral promotion available for resale as described herein;
3. AT&T shall calculate credits for the Word-of-Mouth Promotion by providing to Resellers the cash value of the full referral benefit that AT&T provides to its referring retail customer.
4. AT&T shall calculate credits for the Line Connection Charge Waiver promotion by means of the Reseller Method described herein.

This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

John E. Howard, Chairman

ATTEST:

David A. Wright, Vice Chairman

(SEAL)